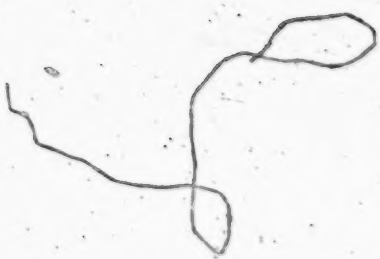

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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1942.

No. 8.

IN THE MATTER OF
THE WESTERN PACIFIC RAILROAD COMPANY,
a corporation,
Debtor.

CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO and SAMUEL ARMSTRONG, as Trustees under The Western Pacific Railroad Company First Mortgage dated June 26, 1916,

v.

Petitioners,

WESTERN PACIFIC RAILROAD CORPORATION, a corporation; THE WESTERN PACIFIC RAILROAD COMPANY, a corporation; IRVING TRUST COMPANY, a corporation, as substituted Trustee under the General and Refunding Mortgage of The Western Pacific Railroad Company; A. C. JAMES CO., a corporation; THE RAILROAD CREDIT CORPORATION, a corporation; FREDERICK H. ECKER, JOHN W. STEDMAN and REEVE SCHLEY, constituting the Institutional First Mortgage Bondholders Committee; and RECONSTRUCTION FINANCE CORPORATION,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR PETITIONERS, CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO AND SAMUEL ARMSTRONG, AS TRUSTEES UNDER THE WESTERN PACIFIC RAILROAD COMPANY FIRST MORTGAGE DATED JUNE 26, 1916.

ORVILLE W. WOOD,
Attorney for Petitioners.

ARTHUR A. GAMMELL,
Of Counsel.

Dated, New York, N. Y., September 15, 1942.

INDEX.

TABLE OF AUTHORITIES CITED.

CASES.

STATUTES.[1]

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[1] Citations to Section 77 of the Bankruptcy Act are too frequent to enumerate. The pertinent portions of Section 77, i. e., subsections (b), (d), (e), and (f), are printed in the Appendix at pages 35, 37, 38, and 43, respectively.

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This is a proceeding to review a decision of the United States Circuit Court of Appeals for the Ninth Circuit rendered on November 28, 1941 (R. 2663, 2675), which reversed an order of the District Court of the United States for the

Northern District of California, Southern Division, entered on August 15, 1940 (R. 1569). The order of the District Court approved a plan of reorganization (hereinafter called the "Commission Plan") for the the Debtor, The Western Pacific Railroad Company, which had theretofore been approved and certified to the District Court by the Interstate Commerce Commission (R. 1600), in a proceeding for the reorganization of the Debtor under Section 77 of the Bankruptcy Act, as amended (11 U. S. C. A., § 205).

OPINIONS BELOW.

The Commission's report and order (R. 194, 284) dated October 10, 1938, approving a plan of reorganization for the Debtor, are reported at 230 I. C. C. 61. The Commission's report and order on further consideration (R. 300, 362) dated June 21, 1939, modifying the plan of reorganization approved in the Commission's report and order dated October 10, 1938, are reported at 233 I. C. C. 409. The Commission's report (R. 884) dated September 19, 1939, on which its order (R. 891) dated September 19, 1939, was entered, denying the Debtor's petition for modification of the Commission Plan, is reported at 236 I. C. C. 1.

The opinion of the District Court (R. 1569) dated August 15, 1940, approving the Commission Plan, is reported at 34 F. Supp. 493.

The opinion of the Circuit Court of Appeals (R. 2663) dated November 28, 1941, reversing the order of the District Court, is reported at 124 F. (2d) 136.

JURISDICTION.

The decree of the Circuit Court of Appeals was entered on November 28, 1941 (R. 2675). This decree was amended, in certain particulars not here relevant, by order of the Circuit Court of Appeals filed February 12, 1942, as amended by order of February 16, 1942 (R. 2681, 2682).

The petition for a writ of certiorari in the instant case (No. 8) was filed on December 29, 1941, and was granted on

April 27, 1942, 316 U. S. . Writs of certiorari were also granted on April 27, 1942, to the Institutional Bondholders Committee (No. 7), the Debtor (No. 20), Reconstruction Finance Corporation (No. 33), and the Trustee under the Debtor's General and Refunding Mortgage (No. 61). The writ granted to the Committee in No. 7 raises issues substantially identical with those involved in the instant case; the issues raised by the writs granted in Nos. 20, 33, and 61 are more limited in scope.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A., § 347(a)) and Section 24(c) of the Bankruptcy Act (11 U. S. C. A., § 47(c)).

STATEMENT OF THE CASE.

A concise statement of the case, containing all that is material to the consideration of the questions here presented, appears at pages 4-27 of the brief of the Institutional Bondholders Committee which is being filed in No. 7. To avoid burdening this Court with what seems an unnecessary repetition, we beg leave to refer to that statement in the brief of the Committee and respectfully pray that that statement be deemed incorporated herein for all purposes of Rule 27.

STATUTES INVOLVED.

The statutory provisions involved are contained in Section 77 of the Bankruptcy Act, as amended (11 U. S. C. A., § 205), and in Section 20a of the Interstate Commerce Act (49 U. S. C. A., § 20a). The relevant provisions are set forth in the Appendix, *infra*, pages 35-45.

QUESTIONS PRESENTED.

The questions presented, as set forth in the petition for certiorari, are as follows:

1. Are the Commission's findings (a) that "the equity of the existing stock has no value" (R. 269) and (b) that

"the claims of the unsecured creditors • • • have no value" (R. 269-270), if supported by the requisite valuation data, sufficient to sustain the Commission's conclusions that the stockholders and unsecured creditors should be excluded from participation in the reorganization?

2. As to the following findings of the Commission: (a) that the securities available for distribution to the secured creditors holding notes secured by the pledge of Refunding Bonds "are inadequate in value to satisfy the aggregate claims of these parties" (R. 271), (b) that the "allocation of reorganization securities to" Reconstruction Finance Corporation "exhausts the value of the collateral pledged by the debtor under the notes held by" Reconstruction Finance Corporation (R. 316), and (c) that "the equity of" The Railroad Credit Corporation "in such collateral has no value" (R. 316),—are these findings sufficient, if supported by the requisite valuation data, to sustain the Commission's conclusions that the "value of each of the claims is proportionate to the collateral securing it" (R. 271) and that the allocation of new securities issued in respect of the pledged Refunding Bonds "should be made on the basis of the collateral held rather than on the amount of the claims" (R. 271)?

3. Should the participation in the reorganization of the holders of First Mortgage Bonds and of the pledgee holders of Refunding Bonds, respectively, be "in proportion to the value of their respective claims", ascertained by determining the exact dollar values of (1) the Debtor's entire property, (2) the property subject to the First Mortgage as a first lien and to the Refunding Mortgage as a second lien, (3) the property subject to the Refunding Mortgage as a first lien, and (4) the new securities distributable to each class? Or should their participation be based upon a determination by the Commission, in terms of the new securities, of the "equitable equivalent of the debtor's assets available for the satisfaction" of the respective claims of each class, giving due effect to the relative priorities of the respective mortgages upon system

earnings at the different levels which such earnings must reach in order to service the various classes of new securities and all other factors which should be considered in order that the District Court may approve the result as being fair and equitable?

4. May not the two claims of Reconstruction Finance Corporation, the one represented by the outstanding Trustees' Certificates and the other represented by notes secured by the pledge of Refunding Bonds, be treated as an "entire bundle of rights" and dealt with on the basis of a practicable and fair compromise which will eliminate the necessity of obtaining elsewhere on less favorable terms the new money needed to refinance the outstanding Trustees' Certificates?

5. Does the present record contain sufficient valuation data to support the Commission's findings and conclusions as to what classes are entitled to participate in the reorganization and as to what new securities should be allocated to each of such classes?

6. Does not Section 77 vest exclusively in the Commission jurisdiction to determine whether a plan of reorganization "will be compatible with the public interest", including jurisdiction to determine the amount, character and financial details of capitalization, and is not the scope of the judicial review of the Commission's determination of such matters limited to an inquiry as to whether the Commission's action was arbitrary or in excess of its constitutional or statutory powers?

7. Should not this Court, upon the entire record, reverse the judgment or decree of the Circuit Court of Appeals and affirm the order of the District Court approving the Commission Plan, in view of the public interest in bringing about a speedy termination of the reorganization proceedings, and in order to prevent further and unnecessary litigation of questions which were before the

Circuit Court of Appeals but as to which the Circuit Court of Appeals made no specific determination?

8. Should the costs of a successful appeal be assessed against mortgage trustees whose appearance as appellees before a circuit court of appeals is occasioned solely by reason of the circumstance that the appellants challenge the fairness of the treatment accorded their *cestuis que trustent* under a plan of reorganization approved by the Commission and by a district court, or should such costs be assessed directly against the Debtor's estate?

SUMMARY OF ARGUMENT.

I. Neither Section 77 nor judicial precedent requires the strait-jacketing of the reorganization process with the rigid valuation formula prescribed by the Circuit Court of Appeals.

II. The Commission's findings are sufficient, in the light of the valuation data in the record, to sustain the exclusion of the unsecured creditors and the sole stockholder from participation in the reorganization.

III. The Commission's findings are sufficient, in the light of the valuation data in the record, to sustain the allocations of new securities among the secured creditors.

IV. The District Court correctly conceived the relative functions of the Commission and of the court in approving a plan of reorganization.

V. This Court should, upon the entire record, reverse the decree of the Circuit Court of Appeals and affirm the order of the District Court approving the Commission Plan.

VI. The costs of the appeal should be assessed directly against the Debtor's estate.

ARGUMENT.

POINT I.

NEITHER SECTION 77 NOR JUDICIAL PRECEDENT REQUIRES THE STRAIT-JACKETING OF THE REORGANIZATION PROCESS WITH THE RIGID VALUATION FORMULA PRESCRIBED BY THE CIRCUIT COURT OF APPEALS.

A. The Valuation Formula Prescribed by the Circuit Court of Appeals.

The Circuit Court of Appeals held that the Commission was under a "duty" to determine and certify to the District Court the "values" of sixteen separate items, to enable the District Court to appraise the fairness of the Commission Plan (1) with respect to the exclusion of the unsecured creditors and the sole stockholder from participation in the reorganization and (2) with respect to the allocation of new securities among the secured creditors. "That duty", said the Circuit Court of Appeals, "was not performed" (R. 2668-2671).

In the light of the extensive valuation findings actually made by the Commission, this amounts to a requirement that the Commission make findings of exact dollar values.

Thus interpreted, the decision of the Circuit Court of Appeals means that the exclusion of the unsecured creditors and the sole stockholder from participation in the reorganization must be based upon a finding of the exact dollar value of the Debtor's entire property. It also means that the allocation of new securities among the secured creditors must be based upon a precise mathematical formula, expressed in terms of equivalents of exact dollar values of claims to exact dollar values of new securities, such dollar values to be ascertained by determining the exact dollar values of the properties securing the respective claims and the respective new securities.

If a "duty" rests upon the Commission to make such findings of exact dollar values, from what source does that "duty" spring?

B. **The Provisions of Section 77.**

Turning to Section 77, one searches in vain for language requiring the Commission to make findings of exact dollar values. Indeed, the statute is barren of mandatory provisions with respect to valuation findings of any sort.

Subsection (d) provides, among other things, that

> "the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. *In such report the Commission shall state fully the reasons for its conclusions.*"[1]

This constitutes the only mandatory provision with respect to findings by the Commission.

Subsection (b) specifies what type of provisions must be, and what type of provisions may be, included in a plan of reorganization. Among those in the mandatory category are "provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise". Among those in the permissive category are "provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise".

Subsection (e) requires that the plan be "fair and equitable", that it afford "due recognition to the rights of each class of creditors and stockholders", that it do "not discriminate unfairly in favor of any class of creditors or

[1] Italics in this brief are ours, unless otherwise designated.

stockholders", and that it "conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders." These requirements would seem to be epitomized in the phrase "fair and equitable."[1]

The statute contains only three provisions referring specifically to findings of value by the Commission. None of them is mandatory.

The first two are the provisions in the second paragraph of subsection (e) that submission of the plan "to any class of stockholders shall not be necessary *if the Commission shall have found*, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or *that at the time of the finding the equity of such class of stockholders has no value*, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity," and that submission of the plan "to any class of creditors shall not be necessary *if the Commission shall have found*, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or *that at the time of the finding the interests of such class of creditors have no value*, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests." Curiously enough, the Circuit Court of Appeals held that findings of "no value" made by the Commission in the exact language of these statutory provisions were insufficient to sustain the exclusion of the unsecured creditors and the sole stockholder from participation in the reorganization and held that a finding of the exact dollar value of the Debtor's property was required (R. 2668).

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[1] This Court, in *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106 (1939), said: "The words 'fair and equitable' as used in §77B(f) are words of art which prior to the advent of §77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations" (p. 115), and which were "used to indicate that a plan of reorganization fulfilled the necessary standards of fairness" (p. 118).

The third provision, which was quoted in part by the Circuit Court of Appeals (R. 2670-2671), is found in the last paragraph of subsection (e), reading as follows:

> "*If it shall be necessary* to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

Had Congress intended a valuation finding by the Commission to be necessary for testing the fairness of every provision in a plan "modifying or altering the rights" of creditors or stockholders, there would have been no reason to insert the qualifying words "if it shall be necessary". Moreover, there is nothing in the language used which requires that findings of "value" under this provision be stated in terms of exact dollar values. On the contrary, the emphasis placed upon earning power as the ultimate criterion of value[1] indicates that a finding of value expressed in terms of earning power translated into new securities would satisfy every requirement of this provision.

The conclusion seems clear that the supposed "duty" of the Commission to make findings of exact dollar values springs not from any express requirement of Section 77; if such a "duty" exists, it must derive from some requirement inherent in the nature of the reorganization process and implicit in the phrase "fair and equitable".

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[1] See *Consolidated Rock Products Co. v. Du Bois*, 312 U. S. 510, 526 (1941).

C. **The Judicial Content of the Phrase "Fair and Equitable".**

Equity Receivership Cases.

The decisions of this Court in *Railroad Company* v. *Howard*, 7 Wall. 392 (1868), *Louisville Trust Company* v. *Louisville, New Albany and Chicago Railway Company*, 174 U. S. 674 (1899)—the *Monon* case,—and *Northern Pacific Railway Company* v. *Boyd*, 228 U. S. 482 (1913), established the so-called rule of "full or absolute priority" as a "fixed principle" for judging the fairness of reorganization plans. The rule was applied in *Kansas City Southern Railway Company* v. *Guardian Trust Company*, 240 U. S. 166 (1916), and was elaborated in *Kansas City Terminal Railway Company* v. *Central Union Trust Company of New York*, 271 U. S. 445 (1926), in which the doctrine of "quantitative preference" was announced. The rule laid down in these cases forms a part of the judicial content of the phrase "fair and equitable."[1]

The Court made clear that in these cases it was prescribing merely a standard of fairness, not a rigid formula.

In the *Boyd* case, the Court spoke of a "fair offer" to unsecured creditors and stated (p. 508):

> "This conclusion does not, as claimed, require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock."

In the *Kansas City Terminal* case, the Court, after referring to the above quoted statement in the *Boyd* case, said:

> "And we now add that, when necessary, they may be protected through other arrangements which distinctly recognize their equitable right to be preferred to stock-

[1] *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, 115 (1939).

holders against the full value of all property belonging to the debtor corporation, and afford each of them fair opportunity, measured by the existing circumstances, to avail himself of this right." (pp. 454-455.)

"But reasonable adjustments should be encouraged. Practically, it is impossible to sell the property of a great railroad for cash; and, generally, the interests of all parties, including the public, are best served by co-operation between bondholders and stockholders." (p. 455.)

"In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights." (p. 455.)

In none of these cases did the Court express a view as to the type of findings needed to test the fairness of a reorganization plan.

In *National Surety Co.* v. *Coriell*, 289 U. S. 426 (1933), one of the cases cited by the Circuit Court of Appeals (R. 2672), this Court held that nonassenting creditors were entitled "to a decree based on adequate data" (p. 435). The opinion referred to the "failure to require relevant data before deciding whether the plan should be approved" (p. 436) and declared that "Every important determination by the court in receivership proceedings calls for an informed, independent judgment" (p. 436). But in that case the Court was dealing with a record wholly lacking in basic valuation data; there was no evidence from which a finding of any kind could be made. To hold that a decree must be supported by proper evidence of value is vastly different from holding that, on a record containing abundant valuation data, the decree must be supported by detailed findings of exact dollar values.

First National Bank of Cincinnati v. *Flershem*, 290 U. S. 504 (1934), another of the cases cited by the Circuit Court of Appeals (R. 2672), sheds little light upon the problem we are considering. In that case, this Court found, from the evidence in the record, that the upset price and the sale price were "grossly inadequate" (p.

524) and held that a nonassenting creditor was entitled to receive "that sum in cash which it would have received if the property had been sold at a proper price" (p. 526). For the purpose of ascertaining that sum, the Court directed a "detailed appraisal" (p. 527) of the assets as of the date of the sale. In that case, the problem was to ascertain a dollar amount to be paid in cash. Our problem is quite different—it concerns the fairness of a plan under which bundles of rights represented by old securities are to be exchanged for bundles of rights represented by new securities.

The *Los Angeles Lumber Products* Case.

In *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106 (1939), also cited by the Circuit Court of Appeals (R. 2672), this Court reaffirmed and clarified the doctrine of the *Boyd* case and concluded that "that doctrine is firmly imbedded in § 77B" (p. 119).

The sufficiency of the valuation findings was not in issue. The District Court had found that the debtor corporation was insolvent both in the equity sense and in the bankruptcy sense, and the facts in the record so clearly showed that the equity of the stockholders was valueless and that the "alleged consideration furnished by the stockholders" (p. 122) was inadequate that the Court had no difficulty in holding that "as a matter of law the plan was not fair and equitable" (p. 114).

The *Consolidated Rock Products* Case.

In the final analysis, the controversy in this case centers upon the correct interpretation of the decision of this Court in *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510 (1941), cited by the Circuit Court of Appeals as its chief authority (R. 2668, 2670, 2671-2672). We believe the Circuit Court of Appeals misconceived the import of that decision.

In the *Consolidated Rock Products* case, the Court said (p. 520):

> "On this record no determination of the fairness of any plan of reorganization could be made. Absent the requisite valuation data, the court was in no position to exercise the 'informed, independent judgment' (*National Surety Co.* v. *Coriell*, 289 U. S. 426, 436) which appraisal of the fairness of a plan of reorganization entails."

On the record before it, the Court could not have done otherwise. What was lacking was basic evidence of value and other basic evidence without which no intelligent conclusion as to the fairness of the plan was possible. What evidence there was threw serious doubt upon the findings made by the District Court. The fatal defect in the findings lay in the failure to make a valuation based upon earning capacity.

The key to the decision, we believe, is to be found in the Court's discussion of the method of valuation:

> "From this record it is apparent that little, if any, effort was made to value the whole enterprise by a capitalization of prospective earnings. • • • Findings as to the earning capacity of an enterprise are essential to a determination of the feasibility as well as the fairness of a plan of reorganization." (p. 525.)

> "The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable. • • • Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance. • • • The extent and

method of inquiry necessary for a valuation based on earning capacity are necessarily dependent on the facts of each case." (pp. 526-527.)

This flexible realistic approach to the valuation problem is the antithesis of the rigid scholastic formula prescribed by the Circuit Court of Appeals.

That this Court had in mind no strait-jacket requirement is further indicated by its discussion of the doctrine of the *Boyd* case. While insisting that "Full compensatory provision must be made for the entire bundle of rights which the creditors surrender" (p. 528), the Court said:

> "Practical adjustments, rather than a rigid formula, are necessary. The method of effecting full compensation for senior claimants will vary from case to case. * * * But whether in case of a solvent company the creditors should be made whole for the change in or loss of their seniority by an increased participation in assets, in earnings or in control, or in any combination thereof, will be dependent on the facts and requirements of each case. So long as the new securities offered are of a value equal to the creditors' claims, the appropriateness of the formula employed rests in the informed discretion of the court." (pp. 529-530.)

> "If the creditors are adequately compensated for the loss of their prior claims, it is not material out of what assets they are paid. So long as they receive full compensatory treatment and so long as each group shares in the securities of the whole enterprise on an equitable basis, the requirements of 'fair and equitable' are satisfied." (p. 530.)

> "Any other standard might well place insuperable obstacles in the way of feasible plans of reorganization." (p. 530.)

We believe that the judicial content of the phrase "fair and equitable" affords no basis for a requirement that the Commission make findings of exact dollar values.

D. The Practical Requirements of the Reorganization Process.

Finding the exact dollar value of a railroad is like finding the product of two variables. It is an attempt to reduce to certainty that which is inherently uncertain.

A valuation "by a capitalization of prospective earnings" involves two preliminary steps. The first step is to make an estimate of the prospective earnings. This at best can be no more than an informed guess and can reach only an approximate result. The second step is to determine what rate of capitalization to use. This involves a problem of judgment, which is complicated by the practical necessity of capitalizing earnings at different rates in determining what amounts of fixed interest debt, contingent interest debt, and stock the earning power of the enterprise will support. The complexity of this problem increases with the number of different types of securities having varying interest and dividend rates into which the new capital structure is to be classified.

The estimate of prospective earnings must be realistically related to the types of new securities which those earnings are to service. For the servicing of fixed interest debt, earnings must be estimated at depression levels. For the servicing of contingent interest debt, they must be estimated at levels which are reasonably certain to be maintained under "normal" future conditions. For the servicing of dividends on preferred and common stock, still higher levels of earnings may be used, depending upon the degree of probability that those levels will be reached with sufficient frequency to give value to the stock. At those rarefied levels, the inquiry reaches increasingly into the realm of the speculative, and to determine the exact point at which probability of future earnings ceases to be even a reasonable hope is obviously impossible.

The result of such a valuation is logically stated in terms of new securities. Nothing useful can be added by an unrealistic attempt to state that result in terms of exact dollar values.

The futility of requiring findings of exact dollar values becomes even more apparent when separate parts of a railroad system are valued for the purpose of determining the allocations of new securities.

By way of illustration, let us assume that a railroad has a number of divisional first and second mortgages and several system mortgages. Each of the system mortgages is a first lien on certain parts of the system and is further secured by the pledge of divisional mortgage bonds or senior system mortgage bonds, or both, and also by the pledge of stocks and bonds of subsidiary companies. Some of the divisional lines show substantial earnings at comparatively low levels of system earnings, while others do not begin to show earnings until system earnings reach higher levels. This is not an imaginary situation: it is typical of some of the railroads now in reorganization.

To measure the value of the assets contributed to the reorganization by each of the various classes of security holders in such a situation presents a staggering problem. Even with the aid of such devices as earnings segregation studies, severance studies, and contributed traffic studies, no approach can be made to scientific accuracy. Findings expressed in terms of exact dollar values would merely lend a pretense of exactness.

Findings of exact dollar values tend to obscure the real nature of the problem of allocations, because they create the impression that the things valued are exactly equal if the dollar values are equal. The problem of allocations is not one of merely matching dollar values of claims and dollar values of new securities, as the Circuit Court of Appeals apparently assumed when it said (R. 2669) that "fairness requires" that the participation of the secured creditors "should be in proportion to the value of their respective claims". Such a rule of distribution would disregard the "fixed principle" of the *Boyd* case. The problem is rather one of comparing bundles of rights—bundles of rights entitling the holders to assert claims against the income and assets in varying amounts and at varying levels of priority.

The problem cannot be resolved by a precise mathematical formula. Its solution calls instead for the exercise of an informed judgment, a careful weighing of many factors, tangible and intangible, which are not a matter of arithmetic.

Mr. Justice HOLMES has said:

> "Delusive exactness is a source of fallacy throughout the law."[1]

In no field is it more important to bear in mind the wisdom of that remark than in the field of railroad reorganization valuations.

POINT II.

THE COMMISSION'S FINDINGS ARE SUFFICIENT, IN THE LIGHT OF THE VALUATION DATA IN THE RECORD, TO SUSTAIN THE EXCLUSION OF THE UNSECURED CREDITORS AND THE SOLE STOCKHOLDER FROM PARTICIPATION IN THE REORGANIZATION.

The Commission found, with respect to the stock, "that there is no equity over and above the securities hereinbefore approved; *that the equity of the existing stock has no value*, and hence holders of such stock are not entitled to participate in the plan." (R. 269[2].)

The Commission found, with respect to the claims of the unsecured creditors, "that even though all the securities remaining available for distribution after satisfying the claims of the first mortgage bondholders are allotted to the other secured creditors, such securities will be inadequate in value to satisfy their claims * * * *that the claims of the unsecured creditors * * * have no value.*

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[1] Dissenting opinion in *Truax* v. *Corrigan*, 257 U. S. 312, 342 (1921).

[2] See also R. 294, 393, and 889.

and hence no securities or cash should be distributed under the plan in respect to those claims." (R. 269-270[1].)

In making these findings of "no value", in the statutory language of subsection (*e*), the Commission made findings of the ultimate facts upon which the exclusion of stockholders and unsecured creditors from participation in the reorganization depends. A finding that the equity of the stock has no value is a finding that the value of the Debtor's property does not exceed the Debtor's liabilities. It is in substance and effect a finding of insolvency in the bankruptcy sense. A finding that the claims of a particular class of creditors have no value is a finding that the value of the property available for the satisfaction of those claims does not exceed the amount of the prior claims against that property. An examination of the record will show that it contains abundant valuation data to support these findings.

The Commission had before it comprehensive valuation data, including traffic studies, data as to past earnings, and an estimate of future earnings, as well as data as to the investment in the property and the physical valuation data contained in the Commission's Section 19a valuation. The Commission's report dated October 10, 1938, recites this data in great detail (R. 203-224), and a reading of that report and of the report dated June 21, 1939, will show not only that the Commission gave due weight to all of the various elements of value but that it expressed a carefully considered judgment as to the relative weight to be given to each (R. 203-224, 244, 245-246, 257, and 310). No one, we believe, can seriously contend that the Commission failed to "state fully the reasons for its conclusions."

Additional valuation data was received in evidence by the District Court (R. 1285-1296 and 1300-1317).

We believe that an analysis of the valuation data in the record will convincingly demonstrate the correctness of the Commission's findings "that the equity of the exist-

[1]See also R. 294, 392, and 889.

ing stock has no value" (R. 269) and "that the claims of the unsecured creditors * * * have no value" (R. 269-270).

The opinion of the District Court contains (R. 1591-1592) a tabulation showing the reported and adjusted earnings available for interest for each of the years from 1922 through 1938 and the first ten months of 1939. Since that opinion was written, earnings figures for the full year 1939 and for subsequent periods through the month of June 1942, have been made available in statements filed with the District Court, which are before this Court pursuant to the stipulation of the parties filed July 23, 1942.[1]

Under the Commission Plan, earnings must reach a level of over $3,500,000 per year in order to pay full dividends on the new preferred stock and must reach a level of over $4,600,000 per year in order to pay dividends of $3 per share on the new common stock.

In only five of the twenty years from 1922 through 1941 did the adjusted earnings reach a level of $3,500,000. Those were the years 1925, 1926, 1928, 1929, and 1941. In only one year (1926) did the adjusted earnings reach a level of $4,600,000.

The adjusted earnings for 1939 were slightly over $1,500,000; for 1940 they were slightly over $2,360,000; for 1941 they were slightly over $3,580,000.

On the basis of the Debtor's past earnings record (through 1941), therefore, the total authorized capitalization provided for in the Commission Plan is, if anything, over-optimistic.

Several of the respondents contended before the Circuit Court of Appeals, and will doubtless contend before this Court, that the recent upward trend of the Debtor's earnings is indicative of a prospective earning power

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[1] A tabulation showing the reported and adjusted earnings available for interest for each of the years from 1922 through 1941 is set forth on page 7 of the brief of the Institutional Bondholders Committee.

sufficient to support a larger capitalization than is provided for in the Commission Plan.

The recent earnings of the Debtor have undoubtedly reflected the effects of increased traffic resulting from the war effort, from the diversion of traffic which would normally pass through the Panama Canal, and from the diversion of traffic which would normally be carried by motor vehicles. These are temporary factors which are a highly uncertain basis for an estimate of future earnings. Against these factors must be offset the possibility of tax increases incident to the financing of the war and the possibility of wage increases and increases in prices of materials, as well as other factors which may produce higher operating costs. War traffic demands are placing a heavy strain upon the physical plant and equipment of the American railroads, while shortages of materials are making adequate maintenance and replacements increasingly difficult. The end of the war may well find the Debtor faced with the problem of financing a rehabilitation program out of greatly reduced earnings.

To erect the new capital structure upon the unsteady foundation of wartime earnings is to build upon a quicksand.

POINT III.

THE COMMISSION'S FINDINGS ARE SUFFICIENT, IN THE LIGHT OF THE VALUATION DATA IN THE RECORD, TO SUSTAIN THE ALLOCATIONS OF NEW SECURITIES AMONG THE SECURED CREDITORS.

A. The Commission's Findings.

The allocations of new securities under the Commission Plan are premised, and we believe correctly premised, upon the complete priority of the First Mortgage over the Refunding Mortgage[1] as a lien on substantially all of

[1] The Debtor's General and Refunding Mortgage.

the Debtor's property, except with respect to certain pledged collateral held by the Refunding Mortgage Trustee.[1] The pledgee holders of Refunding Mortgage Bonds are therefore entitled to receive only (1) whatever new securities are found to be issuable in respect of the pledged collateral on which the Refunding Mortgage is a first lien, plus (2) whatever new securities remain after provision has been made for the refunding of the prior lien Trustees' Certificates and after the holders of the First Mortgage Bonds have been "made whole".

The Commission Plan, after providing for the refunding of the $10,000,000 principal amount of Trustees' Certificates with an equal principal amount of new first mortgage 4% bonds, allocates to the holders of First Mortgage Bonds (a) new income mortgage 4½% bonds in a principal amount equal to 40% of their claim for principal, (b) new 5% preferred stock of a par value equal to 60% of their claim for principal, and (c) new no par common stock in an amount which, taken at $57 per share, is equal to the amount of their claim for accrued interest (R. 317, 390-391). All of the remaining common stock is allocated to the holders of Refunding Mortgage Bonds (R. 317-318, 391-392).

Reconstruction Finance Corporation,[2] which holds all of the outstanding Trustees' Certificates and is also a pledgee holder of Refunding Mortgage Bonds, is given *pari passu* treatment with the holders of First Mortgage Bonds in respect of that portion of its claim which is secured by the pledge of Refunding Mortgage Bonds, as compensation for the sacrifice of rights involved in its acceptance of new long term first mortgage bonds in exchange for the short term Trustees' Certificates (R. 312, 317, 389, 391). As a result of this allocation, the RFC receives 29,360 shares less of new common stock than it would

[1] The determinations of the Commission (R. 261-267) and of the District Court (R. 1597) as to the relative priority of the two mortgages were not disturbed by the Circuit Court of Appeals. The correctness of those determinations is challenged by the petition of the Refunding Mortgage Trustee in No. 61.

[2] Hereinafter referred to as the "RFC".

otherwise receive as a pledgee holder of Refunding Mortgage Bonds. These additional shares of new common stock are allocated to the other pledgee holders of Refunding Mortgage Bonds, namely, The Railroad Credit Corporation[1] and A. C. James Co. (R. 317, 391-392). Common stock is allocated to the RCC at $62 per share.

In addition to their allotment of new common stock, the RCC and A. C. James Co. receive new income mortgage 4½% bonds and new 5% preferred stock in recognition of the value of the pledged collateral on which the Refunding Mortgage is a first lien (R. 315-316). The principal amount of new income mortgage bonds so allocated is equal to the amount of the deposited cash and the principal amount of the Tidewater Southern note held by the Refunding Mortgage Trustee, and the par value of the new preferred stock so allocated is equal to the par value of the Tidewater Southern stock held by the Refunding Mortgage Trustee (R. 313, 315). The Commission found that the lien of the Refunding Mortgage on the pledged securities of Central California Traction Company and Alameda Belt Line "has no material value" (R. 315).

As between the RCC and A. C. James Co., these new securities are allocated in the ratios which their holdings of Refunding Mortgage Bonds bear to the total principal amount of Refunding Mortgage Bonds outstanding, the Commission having found that the new securities "available for distribution are inadequate in value to satisfy the aggregate claims" (R. 271) of the pledgee holders of Refunding Mortgage Bonds, that the "value of each of the claims is proportionate to the collateral securing it" and that the allocation of new securities in respect of the Refunding Mortgage Bonds "should be made on the basis of the collateral held rather than on the amount of the claims" (R. 271).

The Commission further found that the "allocation of reorganization securities to" the RFC "exhausts the value of the collateral pledged by the debtor under the notes

[1] Hereinafter referred to as the "RCC".

held by" the RFC and that "the equity of" the RCC "in such collateral has no value" (R. 316).

The Commission made specific findings with respect to each of the foregoing allocations,[1] and then made the following over-all findings:

> "These securities represent the equitable equivalent of the debtor's assets available for the satisfaction of claims." (R. 316.)
>
> "Based upon our conclusion as to the relative priority, value, and equity of the various claims and the value of the new securities available in exchange therefor, we find that the new securities should be allotted as follows: * * *" (R. 317.)

These findings are in effect findings of "value", expressed in terms of new securities. We believe that they satisfy every requirement of Section 77 and that they are amply supported by the valuation data and other evidence in the record.

B. **The Fairness of the Allocations as Between Holders of First Mortgage Bonds and Holders of Refunding Mortgage Bonds.**

Considering that, as to 40% of their principal claim, the First Mortgage Bondholders are to receive, on a dollar for dollar basis, contingent interest bonds bearing a lower rate of interest and having an inferior lien position, that, as to 60% of their principal claim, they are to surrender their creditor position and receive preferred stock on a dollar for dollar basis, and that, as to their entire claim for accrued interest, they are to receive nothing but common stock on a basis only a little more than favorable than the basis upon which common stock is allocated to holders of Refunding Mortgage Bonds, we believe any con-

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[1] These findings are summarized at pages 18-21 of the brief of the Institutional Bondholders Committee.

tention that the holders of First Mortgage Bonds are too generously treated is clearly without merit.[1]

Inasmuch as all of the remaining common stock is allocated to the holders of Refunding Mortgage Bonds, that common stock represents the entire value of the second lien of the Refunding Mortgage on the property which is subject to the liens of both mortgages. Consequently, it is unimportant to know the exact value of that property or the exact values of the new securities allocated to the holders of First Mortgage Bonds and the holders of Refunding Mortgage Bonds in respect of that property.

In valuing the pledged collateral subject to the Refunding Mortgage as a first lien, the Commission analyzed and discussed in its report dated June 21, 1939, comprehensive valuation data as to Tidewater Southern Railway Company, Central California Traction Company, and Alameda Belt Line, including traffic studies, data as to earnings, and, in the case of Tidewater Southern Railway Company, physical valuation data contained in the Commission's Section 19a valuation (R. 313-315). The Commission made specific findings as to the separate values of the pledged securities of these companies, its finding as to the value of the pledged Tidewater Southern securities being expressed in terms of new securities and its finding as to the value of the pledged securities of Central California Traction Company and Alameda Belt Line being expressed in the words "the lien on the securities of these two companies has no material value" (R. 315).

In the light of the valuation data as to Tidewater Southern Railway Company, we believe no valid contention can be made that the unsecured Tidewater Southern note has a greater value than an equal principal amount of new income mortgage bonds secured by a second lien upon the Debtor's system or that the pledged Tidewater Southern stock has a greater value than an equal par value of new preferred stock.

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[1] See *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510, 527-530 (1941).

We also believe that the data in the record as to the operating losses of Central California Traction Company and Alameda Belt Line (R. 1100-1105, 1309, 1311) fully sustain the Commission's finding that "the lien on the securities of these two companies has no material value" (R. 315).

C. **The Fairness of the Allocations as Between the RCC and A. C. James Co.**

In view of the Commission's findings (a) that the new securities "available for distribution are inadequate in value to satisfy the aggregate claims" (R. 271) of the pledgee holders of Refunding Mortgage Bonds, (b) that the "allocation of reorganization securities to" the RFC "exhausts the value of the collateral pledged by the debtor under the notes held by" (R. 316) the RFC and (c) that "the equity of" the RCC "in such collateral has no value" (R. 316), we submit that the Commission's findings that the "value of each of the claims is proportionate to the collateral securing it" (R. 271), and that the allocation of new securities in respect of the Refunding Mortgage Bonds "should be made on the basis of the collateral held rather than on the amount of the claims" (R. 271) state the obviously correct rule of distribution.

The new securities to be distributed to the RCC and A. C. James Co. comprise all of the new securities remaining after the allocations to the holders of First Mortgage Bonds and after the compromise allocation to the RFC. No additional findings of value are needed to determine the fairness of the allocations as between the RCC and A. C. James Co. Since the RCC and A. C. James Co. are to divide the entire package between them in accordance with a fixed ratio, the value of what is in the package cannot affect the result.

D. **The Fairness of the Compromise Allocation to the RFC.**

The Commission treated the two claims of the RFC as one "bundle of rights" and made an allocation to the

RFC under which the RFC is to receive *pari passu* treatment with the holders of First Mortgage Bonds in respect of its claim as a pledgee holder of Refunding Mortgage Bonds, in consideration of its accepting $10,000,000 in principal amount of new first mortgage bonds in exchange for the $10,000,000 in principal amount of Trustees' Certificates which it holds (R. 312, 317, 389, 391). The basis of the allocation was a practicable and fair compromise. In making this compromise allocation, the Commission took into account the necessity of refunding, or providing new money to pay, the outstanding Trustees' Certificates (which are short term obligations of the Debtor's trustees and rank as an expense of administration prior to the liens of the Debtor's mortgages), as well as the difficulty of financing the retirement of the Trustees' Certificates otherwise than through the RFC (R. 311).

Clearly, the exchange of the short term Trustees' Certificates for long term first mortgage bonds involves a sacrifice of rights by the RFC for which it is entitled to "full compensatory treatment". The question is whether the bundle of rights which the RFC is to receive will give to it more than the full equitable equivalent of the bundle of rights which it is to surrender. This is a question which calls for the exercise of an expert, informed judgment and is a question with which the Commission, by reason of its experience and knowledge of railroad securities, is particularly fitted to deal.

The evidence introduced before the District Court (R. 1530-1567), which indicated the difficulty of marketing the new first mortgage bonds privately (R. 1531-1533, 1545) and which indicated that they probably could not be sold for more than 85 or 90 (R. 1532, 1554), strongly tends to support the Commission's findings.

The problem of dealing with the outstanding Trustees' Certificates is peculiarly one which requires for its solution "practical adjustments, rather than a rigid formula". We believe the Commission has found a fair and sensible solution to that problem.

POINT IV.

THE DISTRICT COURT CORRECTLY CONCEIVED THE RELATIVE FUNCTIONS OF THE COMMISSION AND OF THE COURT IN APPROVING A PLAN OF REORGANIZATION.

The Circuit Court of Appeals criticized, as indicating a "possible misconception" (R. 2672), the following statement in the opinion of the District Court (R. 1588):

> "It cannot be gainsaid that the Commission knows all about the debtor, its property, its history, financial and otherwise, its traffic and revenue, and its financial structure. No official body in the country is better qualified, by reason of experience, ability and specialized knowledge than is the Commission to find the ultimate facts as to the debtor in relation to any of the matters mentioned."

After quoting from the provisions of subsection (e) of Section 77, the Circuit Court of Appeals said (R. 2674):

> "In determining whether a plan of reorganization satisfies the requirements of subsection (e), the court is not concluded by any determination made by the Commission, but may, and must, exercise its own independent judgment; and this is true whether such determination relates to value or to some other subject. Initially, however, the duty of determining the value of any property for any purpose under § 77 rests on the Commission, not on the court."

The above quoted statement of the District Court should be read in the light of the following statement in the District Court's opinion (R. 1596-1597):

> "The two issues of (1) amount and character of capitalization and (2) distribution of new securities are closely related. The determination of the amount and character of the capitalization (a legislative function affecting the public interest) is exclusively within the province of the Commission. The only qualifica-

tion, if any, is that the court shall independently determine whether, in the exercise of its jurisdiction, the Commission has acted fairly, within the bounds of the Constitution, and not arbitrarily. The determination of the questions relating to the distribution of the new securities, including legal priorities and allocations, involves private rights and is a judicial function, within the province of the court."

We submit that the District Court correctly conceived the relative functions of the Commission and of the court in approving a plan of reorganization under Section 77.

Subsection (d) of Section 77, which defines the functions of the Commission in approving a plan of reorganization, confers upon the Commission jurisdiction to determine whether the plan "will be compatible with the public interest." Subsection (e), which defines the functions of the District Court, confers no such jurisdiction upon the District Court. Thus, by the express terms of the statute, jurisdiction to determine whether a plan of reorganization "will be compatible with the public interest" is vested exclusively in the Commission.

We submit that the exclusive jurisdiction of the Commission to determine whether a plan of reorganization "will be compatible with the public interest" includes jurisdiction to determine the amount, character and financial details of capitalization.

It is difficult to imagine a question more clearly involving the public interest than the question whether a railroad is to emerge from reorganization with a sound capital structure. The disastrous effect upon railroad credit and upon the investing public of successive receiverships resulting from unsound capital structures is too well known to require further comment.

Subsection (f) of Section 77 provides that, upon confirmation of a plan, the Commission shall, among other things, "grant authority for the issue of any securities • • • to the extent contemplated by the plan and not inconsistent with the provisions and purposes of" the Interstate Commerce Act.

The phrase "compatible with the public interest" appears in paragraph (2) of Section 20a of the Interstate Commerce Act (49 U. S. C. A., § 20a), which section vests in the Commission "exclusive and plenary" jurisdiction to control the issue of new securities by carriers engaged in interstate commerce. The scope of the Commission's jurisdiction under Section 20a was defined by this Court in *New York Central Securities Corporation* v. *United States*, 287 U. S. 12 (1932) in the following language (p. 27):

> "In creating federal supervision of the issue of securities by interstate carriers, the Congress, so far from making it necessary for the Commission to determine whether there had been compliance with state requirements, expressly provided in subdivision (7) of § 20a that the jurisdiction of the Commission should be 'exclusive and plenary' and that approval other than as specified in that section, should not be necessary."

Section 20a and the decisions construing it form part of the legislative and judicial background against which the phrase "compatible with the public interest" in Section 77 must be construed.

The scope of the judicial review of the Commission's determination that a plan "will be compatible with the public interest" is limited by the well established doctrine of the finality of administrative determinations. A classic statement of that doctrine is contained in the opinion of this Court in *Interstate Commerce Commission* v. *Union Pacific Railroad Company*, 222 U. S. 541 (1912), at pages 547-548:

> "There has been no attempt to make an exhaustive statement of the principle involved, but in cases thus far decided, it has been settled that the orders of the Commission are final unless (1) beyond the power which it could constitutionally exercise; or (2) beyond its statutory power; or (3) based upon a mistake of law. But questions of fact may be involved in the determination of questions of law, so that an order, regular on its face, may be set aside if it appears that

(4) the rate is so low as to be confiscatory and in violation of the constitutional prohibition against taking property without due process of law; or (5) if the Commission acted so arbitrarily and unjustly as to fix rates contrary to evidence, or without evidence to support it; or (6) if the authority therein involved has been exercised in such an unreasonable manner as to cause it to be within the elementary rule that the substance, and not the shadow, determines the validity of the exercise of the power. *Int. Com. Com. v. Ill. Cent.*, 215 U. S. 452, 470; *Southern Pacific* v. *Int. Com. Com.*, 219 U. S. 433; *Int. Com. Com.* v. *Northern Pacific*, 216 U. S. 538, 544; *Int. Com. Com.* v. *Alabama Midland Ry. Co.*, 168 U. S. 144, 174.

"In determining these mixed questions of law and fact, the court confines itself to the ultimate question as to whether the Commission acted within its power. It will not consider the expediency or wisdom of the order, or whether, on like testimony, it would have made a similar ruling. 'The findings of the Commission are made by law *prima facie* true, and this court has ascribed to them the strength due to the judgments of a tribunal appointed by law and informed by experience.' *Ill. Cent.* v. *I. C. C.*, 206 U. S. 441. Its conclusion, of course, is subject to review, but when supported by evidence is accepted as final; not that its decision, involving as it does so many and such vast public interests, can be supported by a mere scintilla of proof—but the courts will not examine the facts further than to determine whether there was substantial evidence to sustain the order."

The applicability of this doctrine to the Commission's determinations of the "public interest" questions under Section 77 is indicated by the expressions of this Court in *Palmer* v. *Massachusetts*, 308 U. S. 79 (1939), and *Warren* v. *Palmer*, 310 U. S. 132 (1940).

In *Palmer* v. *Massachusetts*, this Court said (p. 87):

"The judicial process in bankruptcy proceedings under § 77 is, as it were, brigaded with the administrative process of the Commission. From the re-

quirement of ratification by the Commission of the trustees appointed by the court to the Commission's approval of the court's plan of reorganization the authority of the court is intertwined with that of the Commission."

And in *Warren* v. *Palmer*, this Court said (p. 138):

"The judicial functions of the bankruptcy court and the administrative functions of the Commission work cooperatively in reorganizations."

The dictum of the Circuit Court of Appeals, we submit, is not only contrary to the express provisions of Section 77; it runs counter to a principle of administrative law which has long been established by this Court.

POINT V.

THIS COURT SHOULD, UPON THE ENTIRE RECORD, REVERSE THE DECREE OF THE CIRCUIT COURT OF APPEALS AND AFFIRM THE ORDER OF THE DISTRICT COURT APPROVING THE COMMISSION PLAN.

The opinion of the Circuit Court of Appeals (R. 2663) omits to discuss the correctness of the District Court's determination of many of the issues which were before the Circuit Court of Appeals. Prominent among these issues are those involved in the so-called "lien controversy", which have been specifically brought before this Court for determination by the petition of the Refunding Mortgage Trustee in No. 61.

We shall deal with the issues involved in the "lien controversy" in a separate answering brief to be filed in No. 61. The remaining issues are comprehensively dealt with in the brief of the Institutional Bondholders Committee which is being filed in No. 7,[1] and we shall not burden the Court with a further discussion of those issues.

[1] See, in particular, pages 138-145 of the Committee's brief.

We believe that an examination of the record will convince this Court that the District Court committed no error in approving the Commission Plan.

Unless the questions which the Circuit Court of Appeals left unanswered are settled by this Court, they are likely to become the subject of further litigation, which will result in further and unnecessary delay and expense to the parties concerned. To the end that these reorganization proceedings, which have been pending since 1935, may be speedily determined,[1] we believe that this Court should, upon the entire record, reverse the decree of the Circuit Court of Appeals and affirm the order of the District Court approving the Commission Plan.

POINT VI.

THE COSTS OF THE APPEAL SHOULD BE ASSESSED DIRECTLY AGAINST THE DEBTOR'S ESTATE.

The First Mortgage Trustees in this case are not like ordinary litigants trying a private lawsuit.

The Commission Plan was not proposed by the First Mortgage Trustees. It was formulated by the Commission independently in the exercise of its statutory powers under Section 77, and it was approved by the District Court as being fair and equitable. The efforts of the First Mortgage Trustees before the Circuit Court of Appeals were directed to a defense of the Commission Plan; the Commission did not appear before the Circuit Court of Appeals to defend its plan.

The appearance of the First Mortgage Trustees as appellees before the Circuit Court of Appeals was occasioned solely by the circumstance that the appellants challenged the fairness of the treatment accorded the holders of First Mortgage Bonds under the Commission

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[1] See *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648, 685 (1935).

Plan and in so doing put in issue the relative priority of the lien of the First Mortgage on important parts of the Debtor's property.

We believe that the public interest in the proper determination of questions affecting the fairness of plans of reorganization under Section 77 makes it important that the courts have the benefit of an adequate presentation of both sides of controversies arising in connection with proceedings for the approval of such plans. Accordingly, we submit that assessing the costs of the appeal directly against the Debtor's estate, rather than against individual parties, is appropriate.

CONCLUSION.

We respectfully submit that the decision of the Circuit Court of Appeals should be reversed and that the order of the District Court approving the Commission Plan should be affirmed.

Dated, New York, N. Y., September 15, 1942.

Respectfully submitted,

ORVILLE W. WOOD,
Attorney for Petitioners, Crocker First National Bank of San Francisco and Samuel Armstrong, as Trustees under The Western Pacific Railroad Company First Mortgage dated June 26, 1916.

ARTHUR A. GAMMELL,
Of Counsel.

Appendix.

The Statutes Involved.

Subsection (b) of Section 77 of the Bankruptcy Act, as amended (11 U. S. C. A., § 205(b)), provides as follows:

"(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are not otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations, the retention of all or any part of the property by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds de-

rived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, the amendment of the charter of the debtor, and/or the issuance of securities of either the debtor or any such other corporation or corporations for cash, or in exchange for existing securities, or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

"The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted. The term 'securities' shall include evidences of indebtedness either secured or unsecured, bonds, stock, certificates of beneficial interest therein, certificates of beneficial interest in property, options, and warrants to receive, or to subscribe for, securities. The term 'stockholders' shall include the holders of voting-trust certificates. The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

"The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character. For all purposes of

this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors. In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings. The provisions of section 96 of this title shall apply to a proceeding under this section. For all purposes of this section any creditor or stockholder may act in person or by an attorney at law or by a duly authorized agent or committee subject to the provisions of subsection (p) of this section. The running of all statutes of limitation shall be suspended during the pendency of a proceeding under this section."

Subsection (d) of Section 77 of the Bankruptcy Act, as amended (11 U. S. C. A., § 205(d)), provides as follows:

"(d) The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings

hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

"The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court."

Subsection (e) of Section 77 of the Bankruptcy Act, as amended (11 U. S. C. A., § 205(e)), provides as follows:

"(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice

to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

"If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which

event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided*, That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided, further*, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this

section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

"Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided*, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e): *Provided further*, That if, in any reorganization proceeding under this section, the United States is a

creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance, certified to the court, of a lesser amount by the President of the United States, or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: *Provided further*, That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

"If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property,

and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

Subsection (f) of Section 77 of the Bankruptcy Act, as amended (11 U. S. C. A., § 205(f)), provides as follows:

"(f) Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, all stockholders thereof, including those who have not, as well as those who have, accepted it, and all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it. Upon confirmation of the plan, the debtor and any other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan and the orders of the judge relative thereto, under and subject to the supervision and the control of the judge, the laws of any State or the decision or order of any State authority to the contrary notwithstanding. The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention, and the judge may require the trustee or trustees appointed hereunder, the debtor, any mortgagee, the trustee of any obligation of the debtor, and all other proper and necessary parties, to make any such transfer or conveyance, and may require the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceedings a final decree shall be

entered discharging the trustee or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case. Upon confirmation of a plan the Commission shall, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic, to the extent contemplated by the plan and not inconsistent with the provisions and purposes of chapter 1 of Title 49 as on August 27, 1935, or thereafter amended. The provisions of sections 77a to 77aa of Title 15 shall not apply to the issuance, sale, or exchange of any of the following securities, which securities and transactions therein shall, for the purposes of said sections, be treated as if they were specifically mentioned in sections 77c and 77d of Title 15, respectively: (1) All securities issued pursuant to any plan of reorganization confirmed by the judge in accordance with the provisions of this section; (2) all securities issued pursuant to such plan for the purpose of raising money for working capital and other purposes of such plan; (3) all securities issued by the debtor or by the trustee or trustees pursuant to subsection (c), clause (3) of this section; (4) all certificates of deposit representing securities of, or claims against, the debtor, with the exception of such certificates of deposit as are issued by committees not subject to subsection (p) of this section. The provisions of subdivision (a) of section 78n of Title 15 shall not be applicable with respect to any action or matter which is within the provisions of subsection (p) of this section."

Paragraph (2) of Section 20a of the Interstate Commerce Act (49 U. S. C. A., § 20a (2)), provides as follows:

"(2) *Issuance of securities; assumption of obligations; authorization.* It shall be unlawful for any carrier to issue any share of capital stock or any bond or other evidence of interest in or indebtedness of the carrier (hereinafter in this section collectively termed 'securities') or to assume any obligation or liability

as lessor, lessee, guarantor, indorser, surety, or otherwise, in respect of the securities of any other person, natural or artificial, even though permitted by the authority creating the carrier corporation, unless and until, and then only to the extent that, upon application by the carrier, and after investigation by the commission of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed assumption of obligation or liability in respect of the securities of any other person, natural or artificial, the commission by order authorizes such issue or assumption. The commission shall make such order only if it finds that such issue or assumption: (a) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose."

Paragraph (7) of Section 20a of the Interstate Commerce Act (49 U. S. C. A., § 20a (7)), provides as follows:

"(7) *Jurisdiction of commission as exclusive and plenary.* The jurisdiction conferred upon the commission by this section shall be exclusive and plenary, and a carrier may issue securities and assume obligations or liabilities in accordance with the provisions of this section without securing approval other than as specified herein."